

# FISCAL POLICY CENTER

At Connecticut Voices for Children



## Testimony Regarding S.B. 449

### An Act Concerning the Use of Certain Revenues to Provide Funds for the Budget Reserve Fund, Capital Debt Payments, and Pension Payments

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Finance, Revenue, and Bonding Committee  
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Senator Fonfara, Representative Widlitz, Senator Frantz, Representative Williams, and distinguished members of the Committee:

My name is Wade Gibson. I am the Director of the Fiscal Policy Center at Connecticut Voices for Children, an organization that works to promote the wellbeing of all children through smart public policies and strategic investments. I am here to testify in support of the goals of S.B. 449, which would commit a portion of the state's most volatile tax revenue streams to savings for a rainy day and early payments on the state's outstanding debt, with a specific suggestion as to how the bill could be further strengthened.

As the state budget recovers from the worst recession in generations, it is essential we build up a reserve so that the next downturn doesn't trigger another round of painful cuts, tax increases, and borrowing that compromise Connecticut's ability to invest in the future, grow our economy, and provide opportunity for all of our families. Five years after the official end of the recession, our Rainy Day Fund sits nearly empty, offering little protection against the next downturn.

To prepare our state budget to weather the next storm, we respectfully suggest that the revenues segregated by this bill for savings and debt payment be committed first to replenish the Rainy Day Fund, and then to the other uses outlined in the bill. As drafted, S.B. 449 would segregate all income tax revenues generated from the taxation of capital gains, interest, and dividend income above a "base" level and commit them as follows:

- 50% to replenish the state's Rainy Day Fund
- 25% to pay down the state's outstanding capital debt
- 25% to reduce unfunded liabilities in the state employee and teacher pension funds

**Instead, we recommend 100% of revenues be used initially to replenish the Rainy Day Fund. Once it is full, we recommend 50% of revenues be used to pay down outstanding debt and 50% be used to reduce unfunded liabilities in the pension system.** The Rainy Day Fund's current balance is less than 3% of General Fund appropriations, enough to cover just a few weeks of government operations. According to the National Bureau of Economic Research, the last recession ended five years ago this summer, and the time between recessions

has averaged just five years since World War II.<sup>1</sup> Connecticut could easily face another recession in short order, but without the substantial Rainy Day Fund balances available in the last two recessions. Without a full Fund, we would have had to tax, cut, or borrow an additional \$595 million in the early 2000s recession, and an additional \$1.4 billion in the most recent, Great Recession.<sup>2</sup> Those \$1.4 billion were roughly equivalent to the size FY 2012 tax increases.

Replenishing the Rainy Day Fund would ensure greater fiscal flexibility, a key factor Fitch noted recently in giving state general obligation bonds a negative outlook.<sup>3</sup> Connecticut's overreliance on one-time revenues and low Rainy Day Fund balance, Fitch argued, create substantial "budget vulnerability" at a time of "lingering economic and revenue uncertainty." However, continued revenue momentum, Fitch explained optimistically, could "allow the state to materially improve its reserve position," ensuring the state has the funds and flexibility to mitigate future deficits without resorting to damaging cuts, tax increases, and borrowing. We recommend Connecticut heed this advice, follow past precedent of filling the Fund, and replenish our budget reserve.

**We also support the Governor's proposal to increase the maximum Rainy Day Fund balance from 10 to 15% of net General Fund appropriations.** While the Fund has provided a valuable cushion over the past several recessions, each time it has been swamped by the size of the deficits and drained, leading to cuts, tax hikes, and borrowing as the recessions continued. In light of this, the Governor proposes an increase in the Fund limit from 10% to 15% of net General Fund appropriations. A Fund at that level, which the Center on Budget and Policy Priorities considers best practice,<sup>4</sup> could close nearly all of the deficit in a mild recession like that of the early 2000s.<sup>5</sup>

An increase in the Fund maximum is also warranted because of the removal from the General Fund last year of the federal share of Medicaid (about \$3 billion). The current 10% cap is effectively lower than the same 10% in previous years, as the previous cap was based on a General Fund that was approximately \$3 billion larger. This means the fund is capped about \$300 million lower than beforehand, which equals about 1.5% of net General Fund appropriations. Compared to previous caps, therefore, our current 10% is closer to 8.5% of appropriations.

The Rainy Day Fund would offer greater protection against the next downturn if its reserves were capped at 15%. And, the state would replenish these reserves more quickly were S.B. 449 modified to direct volatile revenues first into the Fund, and then to pay down long-term debts. By bolstering the Rainy Day Fund, this proposal would shield vital public investments in our future from damaging cuts, as well as avoid the necessity to raise taxes or add further to the state's long-term debt obligations during the next downturn. To avoid future budget crises, Connecticut must not only tackle outstanding liabilities but also ensure a steady stream of investment in our assets—children chief among them—so that our economy and revenues grow robustly for years to come.

Thank you for the opportunity to testify before you today.

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<sup>1</sup> National Bureau of Economic Research, US Business Cycle Expansions and Contractions.

<sup>2</sup> Analysis by the Office of the State Comptroller.

<sup>3</sup> "Fitch Rates \$400MM Connecticut GO Bonds 'AA'; Outlook Negative," Reuters, March 4, 2014.

<sup>4</sup> Elizabeth McNichol, Vincent Palacios, and Nicholas Johnson, *Budgeting for the Future: Fiscal Planning Tools Can Show the Way*, Center on Budget and Policy Priorities, February 2014.

<sup>5</sup> Fiscal Policy Center analysis of Comptroller figures.